

Message Text

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SUBJECT: EDRC ANNUAL REVIEW OF ITALY

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1. SUMMARY. EDRC REVIEW ITAL NOV 21 WAS MOST PRODUCTIVE
IN SEVERAL YEARS, THANKS TO WELL-INFORMED DELEGATION
FROM ROME. ITALIANS AGREED IN GENERAL WITH SECRETARIAT
FINDINGS, ALTHOUGH THEY PREDICTED LARGE DEFICIT BALANCE
OF PAYMENTS BECAUSE OF INADEQUATE EXPORT PERFORMANCE. NO
ATTEMPT YET MADE TO FACTOR IN EFFECTS OF OIL PRICE RISES AND
SUPPLY SHORTAGES ON BP AND DOMESTIC PRODUCTIO. MONETARY
POLICY IS GREATEST DILEMMA SINCE ENCOURAGEMENT ECONOMIC
RECOVERY CONFLICTS WITH NEED CONTROL INFLATION. END
SUMMARY.

2. DOMESTIC DEMAND. SECRETARIAT (ANDERSEN) SAW POSSIBILITY
THAT DOMESTIC DEMAND AND INFLATIONARY PRESSURE WILL BE
EVEN GREATER THAN FORESEEN BY EITHER SECRETARIAT OR ITALIANS,
BECAUSE OF ADDED STIMULUS RECENT WAGE SETTLEMENTS, RISING
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PENSIONS, AND POSSIBLE DECLINE IN SAVINGS RATIOS RELATED

TO GROWING CONFIDENCE IN FUTURE EMPLOYMENT PROSPECTS.
ITALIANS CONSIDERED RISK RISING HOUSEHOLD INCOMES LESS
SERIOUS BECAUSE WAGE-EARNERS ONLY GROUP OF INCOME EARNERS
WHICH HAD IMPROVED THEIR POSITION. ITALIANS DID NOT
ANTICIPATE LARGE REDCTION IN SAVINGS RATIO SINCE INFLATIONARY
EXPECTATIONS DID NOT NECESSARILY LEAD TO DECLINE IN
SAVINGS.

3. ANY INCREASE IN PRODUCTIVE CAPACITY TO MEET GROWING
DOMESTIC AND FOREIGN DEMAND WILL DEPEND ON BUSINESS EX-
PECTATION, AND GOVERNMENT PLANS NO INVESTMENT INCEN-
TIVES. ITALIANS SAID CAPACITY UTILIZATION WAS ONLY 78
PERCENT IN THIRD QUARTER, BUT IRON AND STEEL, TEXTILES,
AND WOOD WERE AT HIGHER LEVELS, AND THERE WAS POSSIBILITY
BOTTLENECKS IN ELECTRICITY PRODUCTION. ITALIANS HOPED
INDUSTRIAL PRODUCTION CAPACITY WOULD GROW AT 7 PERCENT
IN 1974, BUT ARE NOT PLANNING TAKE SPECIAL MEASURES
ACHIEVE THIS.

4. PRICES AND COSTS. ALL MEMBERS AND SECRETARAT SAW
INFLATION AS MAJOR PROBLEM, BUT THEY DISAGREED ON HOW TO
CONTROL IT WITHOUT DANGERING ECONOMIC RECOVERY. ITALIANS
ANTICIPATED GRADUAL RELAXATION PRICE CONTROLS EARLY 1974
IN RESPONSE PENT-UP PRESSURES. NOT COUNTING IMPACT HIGHER
OIL PRICES, COMESTIC CPI EXPECTED RISE 9 PERCENT IN 1974
AND IMPORT PRICES 10 PERCENT. WAGES EXPECTED RISE 15
PERCENT AS RESULT 1973 AGREEMENTS, AND ITALIANS EXPECTED
VARIOUS SECTORS WOULD TRY RE-ESTABLISH TRADITIONAL WAGE
DIFFERENTIALS. HOWEVER, THEY DO NOT SEE PROFIT MARGINS
INCREASING MORE THAN WAGES.

5. MONETARY AND FISCAL POLICY. SECRETARIAT MADE CLEAR
ITS PREFERENCE FOR OINTINUED EMPHASIS ON ECONOMIC GROWTH
DESPITE HIGH INFLATION RATE. IN THEIR VIEW THIS MEANT
ABSOLUTE PRIORITY BE GIVEN TO PRODUCTIVE INVESTMENT AND
TO PUBLIC INVESTMENT IN RELATED INFRASTRUCTURE. IF
RESTRAINT NECESSARY, IT SHOULD INVOLVE FISCAL RATER THAN
MONETARY MEASURES. IN PARTICULAR, QUANTITATIVE RE-
STRICTIONS ON CREDIT SHOULD BE RELAXED BEFORE THEY DISCOURAGE
INVESTMENT. ITALIANS NOTED RESTRICTIONS ON CREDIT HAD
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ALREADY BEEN EASED AND GENERAL TONE THEIR POLICIES WAS
FLEXIBLE AND SELECTIVE. THEY WERE IN COMPLETE AGREEMENT WITH
SECRETARIAT CONCLUSIONS. US DEL RAISED LONE VOICE IN WILDER-
NESS TO NOTE SURPRISE THAT EDRC SHOULD RECOMMEND RELAXATION
OF CREDIT POLICY WHEN INFLATION RATE AT 10 PERCENT. HE NOTED
HIGHLY LIQUID STATE OF ECONOMY COMBINED WITH RISK OF EVEN
GREATER DEMAND PRESSURES WOULD SEEM REQUIRE TIGHTENING SHORT-
TERM CREDIT. FAILURE DO THIS COULD MAKE WAGE SITUATION

IN 1974 EVEN MORE EXPLOSIVE.

6. BUDGET POLICY. ITALIAN ASSURED JAPANESE EXAMINER THEY HAD NO INTENTION APPLYING FISCAL RESTRAINT TO PUBLIC INVESTMENT PROGRAM. PRESENT DECENTRALIZATION OF AUTHORITY TO REGIONS HAD SLOWED DOWN PROJECT IMPLEMENTATION BUT THIS WOULD SOON BE RESOLVED. SELECTIVE TAX INCREASES, AS RECOMMENDED BY SECRETARIAT, MIGHT HELP RESOLVE BUDGETARY SHORTFALLS AND PROVEDE MEASURE OF DEMAND RESTRAINT, BUT ITALIANS DID NOT THINK THEY WOULD BE FEASIBLE IN 1974. RECENT FISCAL REFORM HAD YET TO PROVE ITS EFFICACY IN VIEW OF PAST EXPERIENCE WITH WIDESPREAD TEX EVASION.

7. BALANCE OF PAYMENTS. BOTH SECRETARIAT AND ITALIANS MODIFIED THEIR VIDELY DFFERING ESTIMATES OF SIZE OF CURRENT ACCOUNT DEFICIT, BUT ITALIANS CONTINUE TO SEE LARGER DEFICIT THAN SECRETARIAT. ITALIANS SEE NUMEROUS UNCERTAINTIES AFFECTING EXPORT POTENTIAL, AMONG THEM EXPEORT PRODUCTION CAPACITY, DELAYED EFFECTS OF DEVALUATION, INABILITY RECLAIM MARKETS LOST DUE PREVIOUS LAC COMPETITIVENESS. THEY EXPECTED IN 1974 EXPORTS RISE BY 21 PERCENT IN VALUE AND IMPORTS 20 PERCENT, EXCLUDING OIL EFFECTS. OIL PRICE RISES COULD ADD DOLS 500 MILLION TO IMPORT BILL, WHILE OIL SUPPLY CUTBACKS COULD HAVE SERIOUS EFFECT ON TOURIST EARNINGS. ITALIANS NOTED CONTROLS ON CAPITAL FLOWS, COMBINED WITH FOREIGN BORROWNG TO MAINTAIN RESERVES, HAVE SUCCEEDED IN PREVENTING FURTHER DETERIORATION LIRA.

8. EDRC DECIDED NOT TO MAKE SPECIAL REPORT TO COUNCIL ON INFLATIONARY SITUATION IN ITALY.

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